

FEDERAL RESERVE BANK
OF NEW YORK

At circ. no. 8369
June 8, 1978

QUESTIONABLE SECURITIES TRANSACTIONS

*To the Chief Executive Officer of Each State Member Bank
in the Second Federal Reserve District:*

In recent months, it has come to the attention of the Federal banking agencies that a number of banks and other financial institutions have been persuaded by certain securities salesmen to engage in questionable securities transactions involving delayed delivery or forward placement ("forward") contracts and exchange traded interest rate futures ("futures") contracts for Government National Mortgage Association and U.S. Treasury securities. Several financial institutions have suffered significant losses or found themselves in illiquid positions because of these activities.

Although futures and forward contracts may provide, in certain circumstances, a useful and proper way to reduce a bank's interest rate risk exposure, banks should be alert to the dangers that can result from unauthorized or excessive trading or speculation in connection with such activities. State member banks that are permitted to engage in these activities under State law are expected to conduct such securities transactions in a safe and sound manner, with levels of activity reasonably related to the bank's reserves, capital structure, and business needs. State member banks are urged to develop appropriate written policy objectives, and to maintain adequate records and controls, to accomplish this goal.

Federal Reserve examiners will, at the time of their periodic examinations, review the policies, procedures and practices of each State-chartered member bank to determine whether forward or futures trading activities are being conducted in a safe and sound manner and at a level that bears a reasonable relationship to the size and character of the bank's business.

Any questions regarding this matter should be directed to our Bank Examinations Department (Tel. No. 212-791-5897).

PAUL A. VOLCKER,
President.